

CITY COUNCIL STUDY SESSION ITEM

SUBJECT

Updates on the Multi-City Tax Portal Project and the Tax Model Ordinance and potential Bellevue Tax Code amendments.

STAFF CONTACT

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Finance Department

POLICY ISSUES

- **Should the City develop amendments to its tax code to simplify tax reporting for taxpayers?**

The City has historically sought to make compliance with Business and Occupation tax obligations as simple as possible for businesses located in and doing business in Bellevue. To this end staff have adopted relevant portions of the Municipal Tax Fairness Model Ordinance, participated in the Multi-City Tax Portal Project to develop a one-stop online tool for businesses to register and pay local B&O tax, and are continuously evaluating the City's tax code for opportunities to streamline tax filing requirements.

Historical Guiding Principles The following principles guide staff efforts:

- To maintain a taxpayer-friendly environment at the City of Bellevue that is sensitive to the needs of our resident businesses and competitive in the local environment;
- To simplify Bellevue tax code in order to make compliance with Bellevue tax law easier;
- To simplify the administration of the City's tax to minimize costs associated with tax administration; and
- To gain consistency with other taxing jurisdictions where possible.

DIRECTION NEEDED FROM COUNCIL

Action
 Discussion
 Information

- **Direction on proposed changes to the City's tax code to clarify and simplify tax filing and administration for those doing business in Bellevue through:**
 - Administrative changes to ensure clarity for taxpayer;
 - Square Footage Tax Code changes to simplify reporting requirements.

FISCAL NOTES

As of December 31, 2011 Bellevue had approximately 35,000 businesses licensed to do business in Bellevue. Only those taxpayers with annual taxable gross receipts in excess of \$150,000, or greater than 250 taxable square feet, pay the Bellevue B&O tax. In 2011, approximately 18% of those with active Bellevue business licenses paid B&O tax. The B&O tax generated approximately \$24.5 million during the 2011 calendar year.

BACKGROUND/ANALYSIS

The Finance Department regularly searches for opportunities to simplify Bellevue's tax reporting for taxpayers. Additionally, the Department continuously monitors taxpayer compliance with the tax code. The purpose of tonight's discussion is to update the Council on Department efforts related to these matters and seek the Council's direction on a proposed change to the tax code to improve its clarity.

Updates on Simplification Efforts

Multi-City Tax Portal

Five of the largest cities in Western Washington have continued the work started in 2011 to create a multi-city tax portal (hereinafter referred to as the 'Portal'). The purpose of the portal is to improve customer service and ease administrative burden for businesses by providing taxpayers with a single location to register for business licenses, file local tax returns, and make payments for licensing and taxes.

The work group is developing the governance model and functional requirements for the Portal and engaging the business community in validating those requirements. The work group anticipates releasing a request for proposal for the Portal in the fall of 2012. Development of the Portal is scheduled for 2013 with a "go-live" target for the first quarter 2014. More details on the proposed governance and funding models will be presented at a Study Session in November.

Model Ordinance Revisions

Effective January 1, 2008, Bellevue adopted the Municipal Tax Fairness Model Ordinance (the 'Model Ordinance'). The Model Ordinance may not be updated more frequently than every four years except to reflect changes in state law. Recently, representatives from a number of cities, including Bellevue, and the Association of Washington Cities (collectively referred to as the 'Workgroup') gathered to discuss whether an update to the Model Ordinance was appropriate.

Several possible candidates for update were identified at that meeting. The following is a list of the proposed changes, all of which reflect alignment with the State of Washington (definitions for these terms can be found on Attachment A):

- Digital products and digital goods, definitions and sourcing;
- Board of director licensing and tax;
- Repeal of 'Super Nexus' provision;
- Insurance business preemption;

- First mortgage interest deduction; and
- Confidentiality.

The work group agrees that alignment in these areas is appropriate and has drafted proposed changes to the Model Ordinance in consultation with the business community. Pending the results of a stakeholder process initiated by the Association of Washington Cities to review the changes, cities must adopt the mandatory changes with an effective date of January 1, 2013. Attachment A provides a summary of each of these changes and the anticipated impact to Bellevue businesses.

B&O Tax Policy Issues and Proposals

Administrative Code Changes

Issue

Inconsistency, or perceived inconsistency, in the tax code creates confusion and has the potential to make compliance with the code more difficult for taxpayers.

Overview

The Bellevue Tax Code has evolved over the years in response to changes in the business community, the Municipal Tax Fairness Act, and changes in tax administration policy.¹ From time to time taxpayers and the Bellevue Tax Office become aware of inconsistencies within the tax code. The Tax Office documents issues as they become aware of them, and continuously evaluates them to determine whether these issues impact tax policy or administrative policy. Currently the Tax Office has a list of minor issues that do not affect tax or administrative policy, but do have the potential to confuse taxpayers, possibly making compliance with the tax code more difficult.

Proposal

The Tax Office proposes to draft fixes to the identified inconsistencies, such as clarifying the application of the exemption threshold, for review and adoption by the Council. Attachment B provides a list of the currently identified inconsistencies and associated code sections and potential approaches to address the inconsistencies.

Square Footage Tax Code Changes

Issue

The Bellevue Square Footage Tax is difficult for taxpayers to calculate for two notable reasons: the calculation requires that taxpayers distinguish between space used to perform business activities, separate from space used to support business activities, and the calculation requires that taxpayers identify sales of tangible personal property separate from sales of non-tangible items. These complications are discussed in more detail below.

Overview

Bellevue's Square Footage Tax is a complementary tax intended to capture tax on revenue where gross receipts generated in Bellevue is not otherwise captured in the gross receipts tax. The calculation was significantly changed with implementation of the Model Ordinance in 2007 (effective 2008). The

¹ 'Municipal Tax Fairness Act', refers to HB 2030 (2007).

current calculation is based on a combination of factors including gross receipts and the composition and use of square footage in Bellevue. We believe that there is opportunity to simplify the calculation for taxpayers without a significant impact on revenues. The background section below provides specific details about how the tax is calculated and the issues surrounding the complexity faced by taxpayers.

Proposal

The Tax Office proposes to draft solutions to address the above-noted issues that would result in simplification of the square footage tax calculation for taxpayers and allow the Tax Office to simplify the square footage tax calculation form.

The Tax Office will work with the Bellevue business community through the Chamber of Commerce and Bellevue Downtown Association to solicit feedback and input on the proposed changes.

Background

Businesses maintaining a physical location in Bellevue enjoy the benefits provided by the City. Likewise Bellevue-based businesses create demand on Bellevue resources such as roads, police, and fire. Locally-imposed business taxes are intended to defray or compensate the City for the businesses' share of the demands they create on City resources.

Bellevue's business and occupations tax (hereinafter referred to as the 'Bellevue B&O Tax') is imposed on all business with a taxable presence in Bellevue and is intended to compensate the City for the services provided to resident businesses. The Bellevue B&O Tax has two components: a gross receipts tax and a Square Footage Tax ("SFT").

Bellevue Gross Receipts Tax

The gross receipts tax is, as its name suggests, a tax measured by the gross receipts generated by a taxpayer's Bellevue location. The gross receipts tax has several deductions; deductions are specific to the tax classification. The wholesale and retail deductions include deductions for bad debts, discounts, and sales delivered outside of Bellevue. The service tax classification has deductions for bad debts, discounts, and apportionment (the service equivalent of the deduction for sales delivered to customers outside of Bellevue). Both the deduction for sales delivered outside of Bellevue and the apportionment deduction are available to taxpayers who have a physical location in Bellevue, but who deliver products or services outside of Bellevue. The result is that taxpayers who deliver goods or services to customers outside of Bellevue pay gross receipts tax only on those receipts earned from customers who took delivery of the product or service in Bellevue, regardless of the location where the income was generated. Background information on the gross receipts tax is provided for your information, although no amendments to that section of the code are proposed at this time.

The Calculation

To calculate the gross receipts tax, taxpayers perform the following steps:

1. Identify gross reportable receipts;
2. Classify gross receipts into one of seven tax classifications (the majority of taxpayers report in one of three classifications);
3. Determine whether any deductions apply;
4. Calculate taxable income by deducting the allowable deductions from gross receipts; and

5. Calculate the tax due by multiplying taxable income by .1496%.

For perspective, a taxpayer with taxable gross receipts of \$1 million would pay \$1,496 in Bellevue gross receipts tax. The Bellevue gross receipts tax was responsible for approximately \$22.5 million City revenue for the year 2011.

Bellevue Square Footage Tax

The Bellevue Square Footage Tax is a tax measured by the square footage of a business' Bellevue location. Bellevue taxpayers whose Bellevue business activity does not generate income or supports income that is not taxable in Bellevue are primarily affected by the Bellevue square footage tax. An example of a taxpayer who would pay SFT is one who maintains a headquarters office in Bellevue that does not perform any income generating activities in Bellevue. Bellevue was the first Washington city to adopt a SFT, and the tax has been in effect since the 1980's. The SFT was adopted as a compliment to the gross receipts tax to provide equity for businesses maintaining a Bellevue business location and not paying gross receipts tax due to the nature of their business structure and/or deductions.

The Calculation (see Attachment C for Tax Form)

To calculate the Bellevue Square Footage Tax, taxpayers perform the following steps:

1. Determine whether either of the two exemptions from the square footage tax apply to its business and if neither, exemption applies;
2. Identify its total Bellevue square footage;
3. Classify the Bellevue square footage into several classifications of space which include: warehouse, retail selling area, cafeteria, space used to support business activities, and space used to perform business activities;
4. Using the space classified above, perform several additional calculations and arrive at 'net rentable square footage' and 'taxable area supporting business locations outside of Bellevue';
5. Calculate the relationship between certain business activities taxable in Bellevue compared to total receipts for those business activities;
6. Apply the above-calculated ratio to selected types of space, as previously identified. The result is a taxpayer's 'total taxable square footage'; and
7. Multiply the total taxable square footage by the applicable square footage tax rate.

The SFT rate is \$.9318 annually per taxable Bellevue square foot. The SFT was responsible for approximately \$2 million of annual City revenue in 2011.

Local Comparison

Most of Bellevue's neighboring cities have business taxes. The following is a brief table comparing those taxes to Bellevue's taxes.

City	Gross Receipts Tax Rate(s)	Square Footage Tax	Employee Count Tax	Annual License Renewal Fee
Seattle	.15-.415%	Y	N	Y
Kirkland	n/a	N	\$100 per ee/year	Y
Redmond	n/a	N	\$55 per ee/year	Y
Bellevue	0.1496%	Y	N	N

Note: The Seattle Square Footage Tax rate varies depending on the nature of the space and is currently \$.56-1.68 per taxable square foot annually.

Issue Analysis

Evidence of Difficulty

Evidence of taxpayer difficulty interpreting and complying with the SFT Code and calculation is supported by audit results. Specifically, in audits we have consistently found that businesses with a Bellevue location are more likely than not to have either over or under-paid their square footage tax liability. Additionally, Tax Office staff responsible for fielding taxpayer questions via the central tax phone line have noted that they respond to numerous taxpayer questions regarding the SFT calculation. The number of SFT calls compared to general tax call volume appears disproportionate to the amount of revenue associated with the tax.

Complicating Factor One-The concept of distinguishing between space used to perform business activities, separate from space used to support business activities is nebulous and difficult to apply.

Calculating the SFT requires taxpayers to distinguish between three types of space: space used to perform business activities subject to the gross receipts, space used to support business activities and space used to support locations outside of Bellevue. Next, taxpayers must assign square footage values to the preceding three classifications of space. Correctly identifying and valuing these spaces is difficult and time consuming for taxpayers.

Complicating Factor Two-The SFT calculation requires that taxpayers identify sales of tangible personal property, separate from non-tangible sales.

The SFT requires the separate identification of tangible personal property ignoring a myriad of products and services that are commonplace in the current business environment. Often, digital and intangible products and services are offered as a replacement for items that in the past were only offered in tangible form. In most cases these digital and intangible replacements share the same tax classification as their tangible counterparts.

Additionally, the distinction between tangible versus non-tangible sales is not generally required for any other business or reporting purpose. Separate identification of tangible versus non-tangible sales is an additional reporting burden placed on businesses by the City and is cumbersome and time consuming for taxpayers.

ALTERNATIVES

Council may choose to provide direction to staff tonight or direct staff to return with additional information at a subsequent meeting. Alternatives for Council are:

- (1) Direct staff to proceed with drafting tax code changes as proposed to clarify and simplify reporting for taxpayers; or
- (2) Provide alternate direction to staff.

RECOMMENDATION

Alternative 1- Direct staff to proceed with drafting tax code changes as proposed to clarify and simplify reporting for taxpayers

ATTACHMENT(S)

Attachment A-2012 Proposed Changes to the Model Ordinance and Administrative Provisions
Attachment B-Code Change Detail
Attachment B-Schedule B, Square Footage Tax Detail (current calculation).

Council Study Session, September 24, 2012

Finance Department, Tax Division

Attachment A

2012 Proposed Changes to Model Ordinance & Administrative Provisions

A city workgroup met this summer to review changes needed to B&O Model Ordinance. Workgroup members include: Bellevue, Bremerton, Lacey, Longview, Seattle, and Tacoma.

The model ordinance may not be updated more frequently than every four years except to reflect changes in state law. The last update took effect January 1, 2008.

The workgroup, in consultation with the business community, will be revising the model ordinance to include changes to RCW 35.102 and to reflect other changes made to state law since 2008. The model ordinance will be finalized this fall. Cities must adopt mandatory changes to model ordinance with same effective date: proposed January 1, 2013.

1. **Digital Goods Definitions & Apportionment** – Adopt changes required by HB 2620, which amended apportionment in RCW 35.102.130; mirrors changes made to state law in 2009 with adoption of HB 2075 Digital Goods legislation required by Streamlined Sales Tax changes separating digital books, music, and videos goods from their tangible equivalents.
 - .030 Definitions added for digital automated service and digital products
 - .030 Added digital goods references to other mandatory definitions: gross proceeds of sales, manufacture, retail sale, wholesale sale
 - .077 Updates apportionment for digital goods as a separate classification to mirror treatment under state law – 5 steps in order of priority to determine where delivery to buyer occurs
2. **Board of Director licensing and tax** – .030 engaging in business definitions clarification: board meeting nexus exclusion applies to the corporation, not the individual board members or consultants attending meetings.
3. **“Super Nexus”** provision repeal – (.060) reflects requirements that allocation and apportionment provisions in RCW 35.102.130 (.077 of model ordinance) should be used for contracts with the city executed after January 1, 2008.

4. **Insurance business preemption** – (.090) moves exemption from Guidelines to Model Ordinance and updates language to reflect preemption of taxation of insurers/appointed insurance producers in RCW 48.14.020(4) and repeal of RCW 48.17.010-020.
 - RCW 48.14.020(4): The state does hereby preempt the field of imposing excise or privilege taxes upon insurers or their appointed insurance producers, other than title insurers, and no county, city, town or other municipal subdivision shall have the right to impose any such taxes upon such insurers or these insurance producers.
5. **First mortgage deduction** – (.100) updates language to refer to state required tax treatment in RCW 82.14A and moves provision from Guidelines to Model Ordinance.
6. **Confidentiality** – (Administrative Provisions .200) Adopts language of state confidentiality provision RCW 82.32.330, reflecting option that cities may adopt under RCW 35.102.145.

City Council Study Session, September 24, 2012
 Finance Department, Tax Office
 Attachment B, Code Change Detail

Administrative Code Changes				
Code Section	Current Applicable Code	Description of Proposed Change	Tax Impact	
4.09.090(A)	Tax Exemption Thresholds...is less than or equal to \$...for an annual reporting period, regardless of assigned reporting frequency...	Add verbiage to acknowledge that the threshold amount is calculated based on filing frequency. Consistency with long standing administrative policy, consistency with other jurisdictions.	Gain consistency between the tax code and long standing administrative policy. And, consistency with other jurisdictions	None
4.03.040(A)	At the director's discretion, businesses may be assigned to a monthly or annual reporting period depending on the tax amount owing or type of tax...	Add verbiage to acknowledge the annual non-reporting reporting frequency. Consistency with long standing administrative policy.	Gain consistency between the tax code and long standing administrative policy.	None
4.09.030(L)(4)	Attending, but not participating in a "trade show" or "multiple vendor events." Persons participating at a trade show shall review the city's trade show or multiple vendor event ordinances.	Change verbiage to be consistent with the actual title of the applicable code.	Simplify Bellevue tax code research for taxpayers.	None

Square Footage Tax Code Changes				
Code Section	Current Applicable Code	Description of Proposed Change	Tax Impact	
Various	As to such a person who maintains an office or facility that performs or supports an activity...	Consider edits to add clarity to the verbiage 'performs or supports'.	Simplify interpretation and eliminate nebulous language.	None
Various	...for the purpose of this subsection shall include total gross receipts of the business location less receipts from tangible personal property delivered outside the city...	Consider edits to the reference to tangible personal property to acknowledge digital goods and intangibles.	Simplify the calculation, eliminate additional steps in calculation for taxpayer.	Minimal

City of Bellevue
Schedule B—SQUARE FOOTAGE TAX DETAIL



Date Due	Reporting Period	Registration #	

Who should complete this schedule? Taxpayers with a business location(s) in Bellevue should complete this form.

Exempt Taxpayers: You are exempt from square footage tax if **ANY** of the following applies. Check the appropriate box and enter **zero** on **MULTI-PURPOSE TAX RETURN**, line 10, column 4.

- The Net Rentable Area of my Bellevue business location(s) is equal to or less than 250 square feet. *Net Rentable Area equals total square footage of Bellevue location(s) less space used for warehouse, company gym, cafeteria, and/or retail selling area.*
- My Bellevue business location(s) does not support any business locations outside the City, does not make sales of tangible personal property delivered outside Bellevue and does not engage in other business activities. Examples of other business activities include but are not limited to facilities for research and development, and headquarters/regional office space.

STOP HERE if you are exempt from square footage tax. Retain this schedule for your records. **DO NOT attach this form to MULTI-PURPOSE TAX RETURN.** If you do not qualify for exemption based on the criteria noted above, complete the following to compute the portion of Bellevue location(s) space on which the square footage tax is due. Attach this form to **MULTI-PURPOSE TAX RETURN**.

Line No.		Code No.	Amount
Section I Net Rentable Area			
1	Enter total square footage of Bellevue location(s). <i>If you are reporting for more than one Bellevue location on this return, combine the locations.</i>	50	
2	Enter square footage of Bellevue space on line 1 that is used for warehouse, company gym, cafeteria, and/or retail selling area.	51	
3	Net Rentable Area (Subtract line 2 from line 1 and enter amount on this line.) <i>If your Bellevue business location(s) does NOT support business locations OUTSIDE the City, proceed to line 7 and enter the square footage amount from this line on line 7.</i>		
Section II Taxable Area Supporting Business Locations Outside Bellevue			
4	Enter square footage of Net Rentable Area on line 3 that is used to PERFORM business activities subject to gross receipts tax (e.g., space used for marketing, sales, customer services, customer support, etc.)		
5	Support Space (Subtract line 4 from line 3 and enter amount on this line.) <i>This equals the area used to SUPPORT business activities. (e.g. space used for administrative activities such as payroll and/or accounting functions, corporate headquarters, etc.)</i>		
6	Taxable Area Supporting Business Locations Outside Bellevue Enter the square footage of the Support Space listed on line 5 that is used to support business locations OUTSIDE Bellevue. <i>(*If actual amount is not available, compute as noted below.)</i>	52	
Section III Taxable Area for Business Activities in Bellevue			
7	Adjusted Net Rentable Area (Subtract line 6 from line 3 and enter amount on this line.) <i>If Section II did not apply to you then enter the Net Rentable Area from line 3. If your Bellevue location(s) does not make any sales of tangible personal property that is delivered outside the City then proceed to line 11 and enter zero.</i>		
8	Enter total receipts from retailing and/or wholesaling of goods earned by Bellevue locations and delivered outside the City which are not subject to Bellevue manufacturing, extracting, and/or printing gross receipts tax.	53	
9	Enter total receipts earned by Bellevue business location(s). <i>If you are reporting for more than one Bellevue location on this return, combine the locations.</i>	54	
10	Taxable Percentage (Divide line 8 by line 9 and enter amount on this line.)		
11	Taxable Area for Business Activities in Bellevue (Multiply line 7 by line 10 and enter the amount on this line.)		
Section IV Total Taxable Square Footage (Round Square Footage to the nearest square foot)			
12	Total Taxable Square Footage (Add line 6 to line 11 and enter amount on this line and on the MULTI-PURPOSE TAX RETURN , line 10, column 4.)		

Notes

* **Line 6:** Enter actual square footage used for activity described. If actual square footage is not available, the amount on line 6 may be determined using the following formula:

$$\left(\frac{\text{Total Company Receipts} - \text{Total Bellevue Taxable Receipts}^a}{\text{Total Company Receipts}} \right) \times \text{Total Support Space}^b$$

^a **Total Bellevue Taxable Receipts** equals the amount from *Multi-Purpose Tax Return*, line 9, column 4 less the total of the amounts from *Schedule C Multiple Activities Tax Credit Form*, code no. 73 - 79, column 1.

^b **Total Support Space** equals the amount from line 5.